

§ 1.661(c)-1

into the computation of distributable net income in accordance with the rules set forth in § 1.652(b)-3, except that, in the absence of specific provisions in the governing instrument, or unless local law requires a different apportionment, amounts paid, permanently set aside, or to be used for the charitable, etc., purposes specified in section 642(c) are first ratably apportioned among each class of items of income entering into the computation of the distributable net income of the estate or trust, in accordance with the rules set out in paragraph (b) of § 1.643(a)-5.

§ 1.661(c)-1 Limitation on deduction.

An estate or trust is not allowed a deduction under section 661(a) for any amount which is treated under section 661(b) as consisting of any item of distributable net income which is not included in the gross income of the estate or trust. For example, if in 1962, a trust, which reports on the calendar year basis, has distributable net income of \$20,000, which is deemed to consist of \$10,000 of dividends and \$10,000 of tax-exempt interest, and distributes \$10,000 to beneficiary A, the deduction allowable under section 661(a) (computed without regard to section 661(c)) would amount to \$10,000 consisting of \$5,000 of dividends and \$5,000 of tax-exempt interest. The deduction actually allowable under section 661(a) as limited by section 661(c) is \$4,975, since no deduction is allowable for the \$5,000 of tax-exempt interest and the \$25 deemed distributed out of the \$50 of dividends excluded under section 116, items of distributable net

Rents	\$20,000
Dividends	10,000
Partially tax-exempt interest	10,000
Fully tax-exempt interest	\$10,000
Less:	
Expenses allocable thereto (10,000/50,000×\$5,000)	\$1,000
Charitable contributions allocable thereto (10,000/50,000×\$10,000)	2,000
	<hr/>
	3,000
	<hr/>
	7,000
Total	<hr/>
	47,000
Deductions:	
Rental expenses	2,000
Depreciation of rental property	3,000
Trustee's commissions (\$5,000 less \$1,000 allocated to tax-exempt interest)	4,000

26 CFR Ch. I (4-1-03 Edition)

income which are not included in the gross income of the estate or trust.

[T.D. 6777, 29 FR 17809, Dec. 16, 1964]

§ 1.661(c)-2 Illustration of the provisions of section 661.

The provisions of section 661 may be illustrated by the following example:

Example. (a) Under the terms of a trust, which reports on the calendar year basis, \$10,000 a year is required to be paid out of income to a designated charity. The balance of the income may, in the trustee's discretion, be accumulated or distributed to beneficiary A. Expenses are allocable against income and the trust instrument requires a reserve for depreciation. During the taxable year 1955 the trustee contributes \$10,000 to charity and in his discretion distributes \$15,000 of income to A. The trust has the following items of income and expense for the taxable year 1955:

Dividends	\$10,000
Partially tax-exempt interest	10,000
Fully tax-exempt interest	10,000
Rents	20,000
Rental expenses	2,000
Depreciation of rental property	3,000
Trustee's commissions	5,000

(b) The income of the trust for fiduciary accounting purposes is \$40,000, computed as follows:

Dividends	\$10,000
Partially tax-exempt interest	10,000
Fully tax-exempt interest	10,000
Rents	20,000
Total	<hr/>
	50,000
Less:	
Rental expenses	\$2,000
Depreciation	3,000
Trustee's commissions	5,000
	<hr/>
	10,000
Income as computed under section 643(b)	<hr/>
	40,000

(c) The distributable net income of the trust as computed under section 643(a) is \$30,000, determined as follows:

Internal Revenue Service, Treasury

§ 1.661(c)-2

Charitable contributions (\$10,000 less \$2,000 allocated to tax-exempt interest) ..	8,000
	17,000
Distributable net income (section 643(a))	30,000

(d) The character of the amounts distributed under section 661(a), determined in accordance with the rules prescribed in §§ 1.661(b)-1 and 1.661(b)-2 is shown by the following table (for the purpose of this allocation, it is assumed that the trustee elected to allocate the trustee's commissions to rental income except for the amount required to be allocated to tax-exempt interest):

	Rental income	Taxable dividends	Excluded dividends	Partially tax-exempt interest	Tax-exempt interest	Total
Trust income	\$20,000	\$9,950	\$50	\$10,000	\$10,000	\$50,000
Less:						
Charitable contributions	4,000	2,000	.....	2,000	2,000	10,000
Rental expenses	2,000	.....	.....	.....	.....	2,000
Depreciation	3,000	.....	.....	.....	.....	3,000
Trustee's commissions	4,000	.....	.....	.....	1,000	5,000
Total deductions	13,000	2,000	0	2,000	3,000	20,000
Distributable net income	7,000	7,950	50	8,000	7,000	30,000
Amounts deemed distributed under section 661(a) before applying the limitation of section 661(c)	3,500	3,975	25	4,000	3,500	15,000

In the absence of specific provisions in the trust instrument for the allocation of different classes of income, the charitable contribution is deemed to consist of a pro rata portion of the gross amount of each item of income of the trust (except dividends excluded under section 116) and the trust is deemed to have distributed to A a pro rata portion (one-half) of each item of income included in distributable net income.

(e) The taxable income of the trust is \$11,375 computed as follows:

Rental income	\$20,000
Dividends (\$10,000 less \$50 exclusion)	9,950
Partially tax-exempt interest	10,000
Gross income	39,950
Deductions:	
Rental expenses	\$2,000
Depreciation of rental property ...	3,000
Trustee's commissions	4,000
Charitable contributions	8,000
Distributions to A	11,475
Personal exemption	100

	28,575
Taxable income	11,375

In computing the taxable income of the trust no deduction is allowable for the portions of the charitable contributions deduction (\$2,000) and trustee's commissions (\$1,000) which are treated under section 661(b) as attributable to the tax-exempt interest excludable from gross income. Also, of the dividends of \$4,000 deemed to have been distributed to A under section 661(a), \$25 (25/50ths of \$50) is deemed to have been distributed from the excluded dividends and is not an allowable deduction to the trust. Accordingly, the deduction allowable under section 661 is deemed to be composed of \$3,500 rental income, \$3,975 of dividends, and \$4,000 partially tax-exempt interest. No deduction is allowable for the portion of tax-exempt interest or for the portion of the excluded dividends deemed to have been distributed to the beneficiary.

§ 1.662(a)-1

26 CFR Ch. I (4-1-03 Edition)

(f) The trust is entitled to the credit allowed by section 34 with respect to dividends of \$5,975 (\$9,950 less \$3,975 distributed to A) included in gross income. Also, the trust is allowed the credit provided by section 35 with respect to partially tax-exempt interest of \$6,000 (\$10,000 less \$4,000 deemed distributed to A) included in gross income.

(g) Dividends of \$4,000 allocable to A are to be aggregated with his other dividends (if any) for purposes of the dividend exclusion under section 116 and the dividend received credit under section 84.

§ 1.662(a)-1 Inclusion of amounts in gross income of beneficiaries of estates and complex trusts; general.

There is included in the gross income of a beneficiary of an estate or complex trust the sum of:

(a) Amounts of income required to be distributed currently to him, and

(b) All other amounts properly paid, credited, or required to be distributed to him

by the estate or trust. The preceding sentence is subject to the rules contained in § 1.662(a)-2 (relating to currently distributable income), § 1.662(a)-3 (relating to other amounts distributed), and §§ 1.662(b)-1 and 1.662(b)-2 (relating to character of amounts). Section 662 has no application to amounts excluded under section 663(a).

§ 1.662(a)-2 Currently distributable income.

(a) There is first included in the gross income of each beneficiary under section 662(a)(1) the amount of income for the taxable year of the estate or trust required to be distributed currently to him, subject to the provisions of paragraph (b) of this section. Such amount is included in the beneficiary's gross income whether or not it is actually distributed.

(b) If the amount of income required to be distributed currently to all beneficiaries exceeds the distributable net income (as defined in section 643(a) but computed without taking into account the payment, crediting, or setting aside of an amount for which a charitable contributions deduction is allowable under section 642(c)) of the estate or trust, then there is included in the gross income of each beneficiary an amount which bears the same ratio to distributable net income (as so computed) as the amount of income re-

quired to be distributed currently to the beneficiary bears to the amount required to be distributed currently to all beneficiaries.

(c) The phrase *the amount of income for the taxable year required to be distributed currently* includes any amount required to be paid out of income or corpus to the extent the amount is satisfied out of income for the taxable year. Thus, an annuity required to be paid in all events (either out of income or corpus) would qualify as income required to be distributed currently to the extent there is income (as defined in section 643(b)) not paid, credited, or required to be distributed to other beneficiaries for the taxable year. If an annuity or a portion of an annuity is deemed under this paragraph to be income required to be distributed currently, it is treated in all respects in the same manner as an amount of income actually required to be distributed currently. The phrase *the amount of income for the taxable year required to be distributed currently* also includes any amount required to be paid during the taxable year in all events (either out of income or corpus) pursuant to a court order or decree or under local law, by a decedent's estate as an allowance or award for the support of the decedent's widow or other dependent for a limited period during the administration of the estate to the extent there is income (as defined in section 643(b)) of the estate for the taxable year not paid, credited, or required to be distributed to other beneficiaries.

(d) If an annuity is paid, credited, or required to be distributed tax free, that is, under a provision whereby the executor or trustee will pay the income tax of the annuitant resulting from the receipt of the annuity, the payment of or for the tax by the executor or trustee will be treated as income paid, credited, or required to be distributed currently to the extent it is made out of income.

(e) The application of the rules stated in this section may be illustrated by the following examples:

Example 1. (1) Assume that under the terms of the trust instrument \$5,000 is to be paid to X charity out of income each year; that \$20,000 of income is currently distributable to A; and that an annuity of \$12,000 is to be